NEIGHBORHOOD TRUST FINANCIAL PARTNERS

May 15, 2019

Director Kathleen L. Kraninger
Attention: Comment Intake
Consumer Financial Protection Bureau
1700 G Street NW
Washington, DC 20552

Re: Proposed Rulemaking on Payday, Vehicle Title, and Certain High-Cost Installment Loans [Docket No. CFPB-2019-0006, RIN 3170-AA80]

High Quality Credit Access – A Pillar of Financial Stability: Why Payday Loans Inhibit Economic Mobility for Millions of Americans and Must Be Carefully Regulated

A growing body of research on consumer financial well-being has started to coalesce around the conclusion that fast and consistent access to financial buffers is a key driver of long-term financial security and economic mobility. A group of nine leading nonprofits across the United States (including Neighborhood Trust Financial Partners[i]) convened by the Aspen Institute Financial Security Program recently published a report whose principal findings support this insight. According to the report, having enough of a financial cushion (e.g. routinely positive cash flow, liquid savings, high-quality credit access, and/or strong social networks) helps families cope with everyday financial shocks that might otherwise threaten their financial security and mobility.[ii] This brief focuses on two pressing issues: (1) the need to increase consumer access to high-quality, short-term, small-dollar credit as a means for helping everyday Americans weather financial shocks and become more financially secure and (2) the need to support stricter regulation of low-quality credit products, such as payday loans, whose inherently predatory structure harms millions of American consumers every year. **The Consumer Financial Protection Bureau's (CFPB) proposal to rescind key provisions of the regulation promulgated in November 2017 governing Payday, Vehicle Title, and Certain High-Cost Installment Loans, would be a major step in the wrong direction.**

Make No Mistake, Consumer Demand for Short-Term, Small-Dollar Credit is Extremely High:

Each year, nearly 30 million Americans spend $14.5 billion at pawn shops,[iii] 12 million spend $9 billion on payday loans,[iv] and 2 million spend about $3 billion on auto title loans.[v] Additionally, from March 2017 to 2018, more than 39 million consumers overdrafted their bank accounts for a grand total of $34 billion in fees,[vi] almost one-third of whom (more than 12 million people) said they did so as a means to borrow money when they were low on cash.[vii] In short, consumers consistently exhibit unmistakably high demand for short-term, small dollar cash.

Macroeconomic Drivers of Short-Term, Small-Dollar Credit Demand Are Stronger Than Ever:

Market analysis, consumer surveys, and broader industry research studies consistently identify the same set of conditions as catalysts for the aforementioned credit demand. In today's economy, American consumers face the following financial realities:

- 61% would not be able to cover a $1,000 emergency using their savings.[viii]
- 40% would not be able to cover a $400 emergency using their savings.[ix]

- 78% of workers live paycheck to paycheck.[x]
- One in five has no credit history or score.[xi]
- Nearly half of all households experience a change in income of more than 25% over any two-year period.[xii]

These realities are direct consequences of several problematic trends that emerged and gained momentum since the late 1970s in the United States. The cost of higher education has grown dramatically while wages for tens of millions of Americans have stagnated and lost pace with the true cost of living. Job quality for the average worker has eroded tremendously over time - for decades the broader labor force has weathered declining incomes, assets, and access to employee benefits. This has left workers increasingly vulnerable to cyclical downturns or unexpected financial shocks such as a health crisis or loss of income. An increase in part-time and contracted labor has also shifted the costs and burden of paying taxes, getting healthcare, saving for retirement, and securing insurance onto the individual worker.

In today's economy, workers face a daunting list of financial stressors such as unpaid tax bills, high out of pocket health insurance premiums, student loan payments, and no or low retirements savings - all amidst diminished job security. Additionally, in the gig economy model, incomes are even more volatile because they frequently depend on hours worked (variable), not a fixed salary (predictable). Workers are often left guessing what their monthly income will be, piecing it together from multiple sources, and robbing Peter to pay Paul when it doesn't add up as hoped or expected. In the words of one part-time worker and Neighborhood Trust client: "it is both emotionally and financially challenging. I find myself constantly questioning every purchase and expense, not knowing how my income will vary paycheck to paycheck. It also makes it difficult to build up savings of any kind."[xiii]

Neighborhood Trust Supports Efforts to Improve the Quality of Short-Term, Small-Dollar Credit Options:

Neighborhood Trust fervently supports policies that seek to improve job quality - including those that seek to dignify work by paying a livable wage. These are changes that we believe are long overdue and will help bolster some of the other pillars of financial security mentioned above, such as routinely positive cash flow and increased liquid savings. However, in the absence of broader systemic changes to the American economy, we as an organization recognize that our clients will continue to experience the kind of financial shocks that put them in the market for short-term, small-dollar loans. After spending the past 20 years helping over 50,000 low-and moderate-income Americans improve their financial health via financial counseling, we understand first-hand that the need for access to these loans is a reality that should not be ignored. At the same time however, we believe strongly in the need to improve the quality of many loan products currently available to consumers in the marketplace.

The truth about short-term, small-dollar lending, including payday lending, is complex. We at Neighborhood Trust believe that the structure of a standard payday loan ***is*** predatory by design. These loans keep borrowers in a cycle of debt because the lender's business model depends on it - many payday lenders would simply not be profitable without getting borrowers to renew or roll-over their loans somewhere between four and eight times.[xiv] When asked about the rollover component of traditional payday loan products, a team supervisor at Neighborhood Trust remarked, "truthfully, I don't think I've ever seen one of my clients NOT roll over their loan." This Neighborhood Trust staff member's observation is consistent with key findings from several major studies conducted by the CFPB which concluded that: (1) more than 80% of loans are rolled over, (2) around half of borrowers end up taking out ten loans or more in one year, and (3) approximately three-quarters of fees are generated by this extreme re-borrowing.[xv]

Despite how predatory, inefficient, and expensive these loans can be, we at Neighborhood Trust lamentably cannot deny that they, however imperfectly, meet a very real market demand. That said, we believe that the payday loan market is one that's ripe with opportunity for disruption. In listening to our clients and staff members recount their experiences with payday loans, it is immediately clear that they (1) would do everything they can to avoid payday loans, and (2) would have very much preferred having access to a higher-quality alternative.

When asked about these loans, clients and staff member responses centered on a few themes - (1) their need for fast access to short-term, small-dollar credit, (2) the lack of alternatives, and (3) ironically, yet predictably, warning others not to use payday loans as they had:

- "This was the only option. otherwise I would have had to keep sleeping on the floor."
- "I didn't have any family support and I risked being evicted from my place if I didn't take it out."
- "My family members take them out all the time (online) - they need it."
- "The advantage is the instant cash when needed."
- "I love the accessibility of payday loans, but hate the fees, APR amount, and terms of the loans."
- "Folks deny themselves basic things like food, water, electricity… some can borrow from friends and family, but that is few and far between."
- "Seriously consider all your other options, this is a financial trap! I want to help others find alternatives so they do not have the experience that I did!"
- "Just don't do it."
- "I don't recommend them, unless it's dire."

To be clear, Neighborhood Trust wants to see payday lenders put out of business by high quality credit alternatives. At the same time however, it is important to recognize that simply regulating payday lenders out of existence without presenting consumers with safe, affordable, and transparent alternatives would fall short of the mark. While payday loans ***are*** predatory, consumer advocates need to apply more nuance to their efforts to abolish them. It is problematic to simply assume that consumers will "find a way" or "manage" if payday loans are made illegal across the entire U.S. We know first-hand that, even in states that have banned payday lending, such as in New York, there is still tremendous demand for short-term, small-dollar cash which leads to very expensive borrowing via loan sharks, pawn shops, or reliance on bank overdraft "protection".

High Quality, Short-Term, Small Dollar Credit Criteria Defined:

Neighborhood Trust stands behind Pew Charitable Trusts' research on product features and standards that should be incorporated into any short-term, small-dollar loan. Neighborhood Trust supports regulation that pushes the industry to offer high quality credit products that adhere to the following features:

- Affordable installment payments of no more than 5% of each paycheck or 6% of deposits into a checking account.
- Double-digit APRs that decline as loan sizes increase.
- Total finance costs that can be no more than half of the loan principal.
- Loan payments that cannot trigger overdraft fees.

- Online or mobile applications that (1) appropriately take into account a borrower's ability to pay and (2) have automated loan approval so funds can be quickly deposited into a borrower's checking account.
- Credit bureau reporting of loan terms and repayment so that borrowers build credit and can eventually graduate into even more affordable credit options.
- Any fees, other than an application or annual fee, should be charged monthly to ensure they are spread out over the life of a loan. Such a structure would not penalize borrowers who repay early or create an incentive for lenders to refinance loans.
- Each lender should ensure that it is offering one small loan at a time to borrowers.

Payday Lenders Are Structurally Incapable of Offering High Quality Credit:

Neighborhood Trust is heartened to see more states passing regulation that requires payday lenders to offer higher quality loan products (some recent examples including Ohio, Colorado, Arizona, Montana and South Dakota).[xvi] Our perspective stands in direct contrast to that of the Community Financial Services Association of America (CFSAA - a trade association representing the payday loan industry) that argues that these rules make payday loans unprofitable. If payday loans are unprofitable, they argue, access to crucial financial flexibility that millions of borrowers rely upon will dry up - hundreds of payday lenders will be forced to terminate their employees and go out of business. With approximately 23,000 payday lenders in operation across the country however, Neighborhood Trust believes the industry is well positioned to withstand some consolidation - payday lenders with the most efficient operations would have the best chance at remaining profitable in the face of more stringent regulation.[xvii]

While CFSAA is almost certainly overstating the damage that consumer-friendly regulations will have on the payday loan industry as a whole, Neighborhood Trust nevertheless recognizes that their business model would struggle. Many payday lenders have high client acquisition costs and operational overhead expenses - they use instant-loan approvals with bare-minimum underwriting standards and are able to offset costs with the fees they collect from their triple digit APRs and rollover payments. Regulation that forces payday lenders to dramatically improve their underwriting standards, place interest rate caps on their loans, and follow other mandates that increase the overall quality of their product would undoubtedly cut into their profits.

This is precisely why Neighborhood Trust believes the industry is ripe for disruption - if payday lenders are accurate in their assertion that their business model can't survive regulatory mandates that push them to offer higher quality credit products, then a tremendous market opportunity exists for those who can.

Who Might We Look to for High Quality Alternatives?:

When the Pew Charitable Trusts surveyed payday loan customers regarding numerous possible payday loan reforms, the single most popular reform was to enable banks and credit unions to offer small loans at significantly lower prices than those charged by payday lenders. In fact, four in five payday loan customers said they would prefer to borrow from their banks or credit unions.[xviii] In many cases, credit unions – especially Community Development Credit Unions - are already answering the call for high quality alternatives to payday loans. In 2018 alone, with an average loan size of a little under $2,500, Community Development Credit Unions disbursed almost $2.5 billion dollars in traditional consumer loans with APRs below 18%.[xix]

Additionally, it's also possible that the sophistication in operations of many banks and credit unions could present even more opportunity to offer high quality, short-term, small-dollar loans in an economically viable way. Banks and other credit unions could prescreen and automate much of their lending processes, disburse loans into customers' checking accounts, and schedule affordable payments that coincide with their customers' cash flow so that they can comfortably repay.[xx] According to Pew Charitable Trusts' research, these operational advantages could allow banks and credit unions to offer loans profitably at prices estimated to be six times lower than those of payday and other similar lenders.[xxi] Banks and credit unions could keep their costs lower than non-bank lenders in two primary ways: (1) customer acquisition costs would be much lower because borrowers will already be customers who transact with the financial institution on a regular basis, and (2) underwriting would be less expensive because much of the loan disbursement process could be automated.[xxii]

Neighborhood Trust is very intrigued by U.S. Bank's recent foray into this space with a product that is meant to accomplish the rare feat of having a loan disbursement process fast enough to compete with payday loans. Additionally, U.S. Bank's new product offers monthly payments that don't exceed 5% of a borrower's monthly income, an APR of about 70%, and a structure whereby loan payments themselves are prohibited from provoking an overdraft fee (although loan payments may bring one's account balance low enough to allow other routine bills to trigger an overdraft fee).[xxiii]

Other emerging products that Neighborhood Trust is watching closely are employer-based payday loan alternatives, such as Employee Hardship Funds and Employer Based Loans.[xxiv] Payday loan alternatives such as Spring Bank's Employee Opportunity Loan[xxv], Rhino Foods' Income Advance Program,[xxvi] HoneyBee's 'Early Pay' and 'Extra Week's Pay' product offerings[xxvii], and Community Loan Center's Financial Benefits for Employees all present interesting models which warrant more attention and study.[xxviii]

Consumer Advocates Must Speak Up:

It is imperative for consumer advocates to raise their collective voices and represent the needs, interests, and experiences of everyday workers. Just because there is large market demand for a given product, does not mean that product is free from harm. Payday loans are inherently predatory - Neighborhood Trust supports regulation that helps bring their product features in line with the high quality credit standards outlined above. Relaxing regulation of the payday loan industry would be a mistake and hurt consumers who can afford it least.

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[i] Neighborhood Trust Financial Partners is a nonprofit social enterprise that empowers low-income workers to achieve their financial goals and to become productive participants in the U.S. financial system. We provide financial counseling and access to carefully curated products focused on the challenges confronting most working households today: cash-flow shortfalls, budgeting, emergency savings, and debt management.

To maximize our impact, we deliver our counseling in settings that are convenient to workers, including the workplace, financial institutions, and community nonprofits, and we link our clients to safe, affordable financial products. The end result is workers who are more confident and less stressed about their finances, who build healthy balance sheets and work towards wealth creation goals like starting a new business or helping their child go to college. Annually we reach more than 10,000 low- and moderate-income workers across the country.

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